offering both local and long distance services, initially to customers in New York City.[83]

CAPs have several advantages over LECs. Once a CAP has built its core fiber ring in a metropolitan area, the incremental cost of serving additional customers is quite low, relative to the potential gain in revenue.[84] Moreover, because CAPs target their entry selectively to high-volume, low-cost business customers, they can exploit those price averaging requirements still applicable only to LECs.[85] Finally, because CAPs have chosen not to serve high-cost areas, they have a distinct cost advantage over LECs.[86] CAPs are exploiting these advantages of asymmetric regulation as they expand into switched access and even exchange services.[87]

Between 1992 and 1993, CAP revenues increased by 43%, and some sources expect CAP revenues to more than triple by 1996.[88] The competitive presence of CAPs in certain services and areas is quite large. One study shows that CAPs

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[83] Id. Teleport responded to MFS's announcement of its Intelenet service by noting that Teleport had been providing local exchange service in New York City for two years. Id.

[84] Harris at 9.

[85] Id.

[86] Id.

[87] See id.

[88] Harris, Appendix B, p. B-5.

have captured approximately 30% of high-capacity dedicated services (special access and intraLATA point-to-point services for DS0, DS1, DS3, etc.).[89] Another study concludes that CAPs have captured 36% and 32% of total revenue for high capacity transport services from point (customer or POP) to POP in downtown Los Angeles and San Francisco, respectively.[90] Further, recent surveys confirm that a substantial proportion - between 62 and 77 percent - of large business customers rely on CAPs for at least part of their access service needs.[91]

Wireless services also threaten LEC access revenues. Cellular revenues have grown almost 600% over the last five years, and cellular subscribers have grown almost eight-fold during that period.[92] While cellular service has generally been priced higher than landline service, cellular prices

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[89] Id. at B-6.

[90] Id. CAPs have also captured 43% of high capacity transport services in New York City and 36% in Boston. Id.

[91] Huber at 40. It is important to note that many CAPs are well-capitalized, financially strong companies. Teleport, for one, is owned by several of the nations largest cable operators including TCI, Cox Enterprises, Continental Cablevision and Comcast. Id. at 36. MFS is a publicly traded company with a market value of nearly $2 billion. Harris, Appendix B, p. B-15. Recently, MCI announced a $2 billion program to build competitive access networks and install switches in about 20 major metropolitan areas by the end of 1996. See "MCI Goes to 'War' to Promote Local Exchange Competition, Will Spend $2 Billion Building Networks in 20 Cities," *Telecommunications Reports*, January 10, 1994, p. 1.

[92] See Harris at Appendix B, p. B-12, Figure B-7.

are dropping rapidly.[93] Indeed, in certain areas, cellular may be cheaper than landline for short distance inter-exchange calls.[94]

Of course, cellular is only part of the wireless picture. Last Fall, the Commission allocated spectrum and adopted rules governing the provision of a Personal Communications Service (PCS) in the 2 GHz band.[95] Forecasters project rapid growth for PCS with up to 40% residential penetration by the end of the decade and over 60 million users within 10 years.[96] PSC will compete directly with local telephone and cellular services.[97]

It is not surprising that the wireless field is attracting participants who are actual or potential LEC competitors. In August 1993, AT&T announced a proposed $12.6 billion merger with McCaw Cellular, the nation's largest cellular provider.[98] Moreover, cable television companies

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[93] Id. at B-12.

[94] See id. at B-12 - B-13.

[95] Amendment of the Commission's Rules to Establish New Personal Communications Services, GEN Docket No. 90-314, Second Report and Order, supra.

[96] See Huber at 50-51.

[97] See id. at 51. Other wireless services, such as the enhanced special mobile radio service offered by Nextel, will also compete with LEC services. See id. at 49-50.

[98] See "Proposed AT&T - McCaw Cellular Merger Revives Significant Questions about Local Loop Competition," *Tele-*
(continued...)

are aggressively pursuing PCS opportunities. Approximately 18 percent of the applications for experimental PCS licenses have been filed by cable operators.[99]

LEC access competition will also come from less obvious, but still formidable, sources. Other LECs, operating out of their serving areas or regions, are likely competitors for access services, particularly in partnership with cable operators or other service providers.[100] Gas and electric utilities are also potential competitors.[101] Indeed, electric utilities have strong financial incentives to construct fiber optic/coaxial facilities directly to their customers in order to facilitate demand-side load management and other utility-related functions.[102] These facilities

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[98](...continued)
communications Reports, August 23, 1993, p. 3. Besides cellular, both AT&T and McCaw are moving into PCS. See Huber at 61.

[99] See Huber at 51. It is worth noting that MCI recently announced a wireless venture with Nextel and Comcast. See "MCI Plans to Invest $1.3 Billion in Nextel; New Strategic Alliance Includes Comcast," *Telecommunications Reports*, March 7, 1994, p. 22.

[100] See Harris, Appendix B, p. B-17. While 2 notable LEC/cable alliances (Bell Atlantic/TCI and Southwestern Bell/Cox) have recently been canceled, others are going forward including U.S. West's relationship with Time Warner, and Bell South's investment in Prime Management. See id. at B-23.

[101] See id. at B-19.

[102] See Michael R. Niggli and Walter N. Nixon, III, "A Serendipitous Synergy: Why Electric Utilities Should Install the Information Superhighway," *The Electricity Journal*, February 1994, p. 25.

will have substantial remaining capacity to carry video, voice and data communications.[103]

Finally, competition in local access markets will expand rapidly as a result of legislative and regulatory initiatives, both federal and state. Besides the Commission's pro-competitive policies discussed above, Congress appears intent on ensuring that entry restrictions are removed from all telecommunications markets. For example, pending bill H.R. 3636 (the National Communications Competition and Information Infrastructure Act of 1993) states that "no State or local government may . . . effectively prohibit any provider of any telecommunications services from providing that or any other service, or impose any restrictions on entry into the business of providing any such service . . . ." Similarly, S. 1822 (the Communica-

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[103] See id. In addition to competitive service providers, many large end users utilize "self-supply" to meet their telecommunications needs between multiple, commonly-owned locations. See Harris, Appendix B, p. B-8. Private branch exchanges can connect directly with CAP networks, thus eliminating the LEC from the provision of intra-office services. Id. Private customer networks, in particular VSAT networks, are becoming an increasingly popular option enabling large business users to connect many locations over a very wide area without utilizing either LECs or IXCs. From just 1991 to 1993, the number of VSAT terminals grew 54% from 67,000 to 103,000. Id. at B-8 - B-9. While there is nothing inherently wrong with end users engaging in self-supply, there is reason to believe that at least in some cases, they are motivated by regulations that require uneconomic pricing and/or inhibit the offering of new services by the LEC. In those cases, self-supply through private networks is contrary to economic efficiency and other public policy objectives. Harris at 7, n. 8.

tions Act of 1994) lists as an expressed goal the "removal of all State and local barriers to entry into the telecommunications services market . . . ."

Many states are not waiting for Congress to act. By USTA's count, at least 43 states now permit some form of competition, such as intraLATA toll or intrastate private line. A few jurisdictions, most notably New York, either permit local exchange competition or have it under consideration.

These comments cannot possibly cover all the evidence of competition in the local exchange and access markets.[104] These comments, however, do support two important conclusions. First, access competition already exists in many markets, and in larger metropolitan areas such competition is extensive. Second, local access competition will increase rapidly as a result of the growth of wireless services, alliances between telecommunications service providers, and the elimination of regulatory barriers.

D. The Commission's Policies Must Reflect the Substantial Changes That are Taking Place in LEC Markets.

The Commission acknowledges that the current LEC price cap plan "impose[s] significant regulatory constraints upon carriers" which "may become unnecessary or counterproductive

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[104] See Harris at 8-11 and Appendix B; and Huber for more complete descriptions of local exchange competition.

when market forces generated by competition effectively assure reasonable, and not unreasonably discriminatory rates."[105] The Commission further notes that "[r]ate regulation in these circumstances may impede the incumbent carrier's ability to compete vigorously rather than protecting customers or achieving the other goals of the Communications Act."[106] Despite these observations, the Commission suggests that effective LEC competition, while inevitable, has yet to occur.[107] For this reason, the Commission states that it is not proposing a transition plan for price caps, but instead will "use this proceeding to develop data and information relevant to fashioning a workable plan for revising the baseline price cap model as competition develops."[108]

Based on the facts presented above, USTA submits that competition already exists in LEC access markets.[109] Moreover, competition, spurred by changing technology and customer demand, can be expected to increase at a rapid pace.[110] Today, many customers have a choice among two or

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[105] NPRM, ¶ 92.

[106] Id.

[107] See id. at ¶¶ 93, 94.

[108] Id. at ¶ 94.

[109] See Harris at 10.

[110] See id.

more access providers. Under these circumstances, it is incumbent upon the Commission to implement now a mechanism by which LECs in competitive markets can obtain relief from rigid pricing rules that were developed under entirely different market conditions.[111] Without such action, effective competition will be substantially delayed, and service providers (both LECs and non-LECs) and customers will make important investment and purchasing decisions based on false market signals.[112] Additionally, if LECs continue to be handicapped in competing for high-volume, low-cost customers with a choice of service providers, LECs will be less able to provide reasonably-priced, high-quality service to other market segments that are not attractive to new market entrants, such as residential, small business and rural customers.[113]

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[111] See MTS and WATS Market Structure, CC Docket No. 78-72,. Phase I, Third Report and Order, 93 FCC 2d 241 (1983), modified on recon., 97 FCC 2d 682 (1983), modified on further recon., 97 FCC 2d 834 (1984), affirmed in principal part and remanded in part, National Association of Regulatory Utility Commissioners v. FCC, 737 F.2d 1095 (D.C. Cir. 1984), cert. denied, 469 U.S. 1227 (1985), modified on further recon., 102 FCC 2d 849 (1985).

[112] Among other implications, LECs could lack the financial incentives to invest heavily in network infrastructure, see Harris at 11, and/or the National Information Infrastructure could be constructed inefficiently, at a higher cost to consumers than in a fully competitive market.

[113] See Harris at 11. In developing policies for the transition to full competition, the Commission must also recognize the important role that LECs have played, and will continue to play, in facilitating competition and interconnection. Id. Substantial LEC investment in switching

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Professor Harris notes that in view of the accelerating rates of change in technology, customer needs and competitive conditions, regulatory policies must be forward-looking and must anticipate the changes that are taking place.[114] Further, given the rate at which competition is developing, and the competitive handicaps that are now placed on the LECs, the Commission's regulatory "policies should accelerate the transition from quasi-competitive to fully competitive markets by removing distortions that bias customer choice and harm competition."[115]

In its Petition in RM-8356, USTA proposed access services pricing reform that tied the degree of LEC price regulation to the level of competition in a particular market area.[116] As discussed further in Sections IV.B and C below, USTA strongly urges the Commission to adopt the proposed pricing reform in this proceeding as an integral part of its price cap review. Such action will provide the most expedient route for transitioning to a new market

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[113](...continued)
facilities and common channel signalling have helped to make possible "equal access" competition among IXCs and 800 number portability. See id. LECs will continue to serve as the "network of networks," providing interconnection and ensuring interoperability across a growing number of competing and cooperating networks and services. Id.

[114] Id.

[115] Id.

[116] See USTA Petition, pp. 24-33.

environment, for reducing regulatory burdens, and for bringing the full benefits of competition directly to the rate-paying public.

IV. USTA's PROPOSAL FOR PRICE CAP REFORM.

The above comments demonstrate that while the existing price cap plan has served the public interest, the plan will not permit the Commission to achieve all of its objectives in future years. In particular, because it incorporates the features of rate of return regulation, the current LEC price cap plan fails to provide strong incentives for LEC efficiency initiatives, innovation and network development. LEC incentives are further dulled by the rigid Part 69 rate structure requirements which makes the timely introduction of new customer options and services an exceedingly difficult, if not impossible, task. Additionally, the existing plan provides no procedures for transitioning to a less restrictive, more flexible, form of regulation as technology, customer demand, and exploding competition continue to transform LEC access markets.

USTA believes that substantial regulatory reform is necessary to further the Commission's policy goals. The fact that some rules are contained in the Part 61 price cap provisions, while others are in Part 69, is immaterial to what should be the prime objective of this proceeding - changing the existing regulatory framework so that it will

reflect the realities of today's telecommunications market, and will best serve the public interest. The proposals set forth below are intended to accomplish precisely that.

A. The Profit Sharing/Low-End Adjustment Mechanism Must Be Eliminated - Baseline Issue 4b.

As explained above, the sharing mechanism was adopted by the Commission as a way of adjusting rates in the event of unanticipated errors in the price cap formula's productivity factor.[117] Sharing was one component of a "backstop" program which also included a low-end adjustment mechanism that allowed a LEC to raise its price cap indices (and thereby charge higher rates) if it experienced earnings below a specified threshold.[118] As discussed below, this backstop - which closely links price caps to rate of return regulation - has no place in a revised price cap plan.[119]

USTA has shown that the price cap plan's sharing mechanism severely dampens LEC incentives to operate more efficiently. The efficiency incentives under the current plan are only marginally better than under rate of return regulation.[120] Simply put, the prospect of having to share

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[117] See discussion at Section II.A above; Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd at 6801.

[118] See Second Report and Order, supra.

[119] See Harris at 19 for a discussion on why the backstop mechanism lacks a valid economic rationale.

[120] See SPR Report, pp. 22-23.

half or all of any significant productivity gain greatly reduces a LEC's incentive to undertake productivity improvements. Professor Harris notes "that we need the undiluted incentives that [pure] price regulation offers to stimulate the best possible performance from managers and employees . . . ."[121]

The incentive-dampening impact of sharing also makes it less likely that LECs will innovate or make substantial network investment. A LEC will only introduce a new service, or undertake a network infrastructure project, where the anticipated return from the activity is commensurate with the project risk.[122] Because sharing caps overall return levels, and not just prices, the expected returns from all new service offerings and investment projects are lowered under sharing, and it becomes more difficult to justify the necessary expenditures for any particular new service or investment project.[123]

The elimination of sharing will improve the incentives to invest domestically, which will spur economic growth.

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[121] Harris at 20. Pure price regulation without sharing comes closest to replicating the incentives of a competitive market. See Harris at 21.

[122] Darby (Attachment 3 to these comments) contains an extensive discussion of LEC investment behavior as it relates to incentive regulation.

[123] The Commission's regulatory policies, including sharing, affect both the risks of making an investment and the expected future benefits. See Darby at 15.

The price cap LECs and their parent corporations operate in a global financial market where the relatively unrestricted flow of capital between nations facilitates international investments and business ventures. This global market will direct resources to their most productive use. To obtain capital from these markets, LECs must compete with other firms around the world.[124]

Like most businesses, LECs and their parent corporations have found that global funds tend to seek out investments with the highest risk-adjusted return. If LEC earnings are limited in certain areas of their business, as they are for services under the sharing mechanism, the global money market will direct funds to alternative investments with greater returns. To the extent that these investments are made overseas, economic growth prospects in this country would be diminished.[125]

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[124] See Darby at 5-6; see also Harris at 20 (Undiluted price cap regulation is necessary "to attract sufficient capital to modernize and further expand the telecommunications infrastructure.")

[125] Several LECs and/or their parent corporations have already made substantial investments in international telecommunications ventures, and USTA is not suggesting that sharing is the only factor that influences decisions on how LEC resources are allocated between regulated and non-regulated businesses, or between domestic and international. Indeed, the form of intrastate regulation, which applies to approximately 75% of a LEC's regulated business, will have a substantial impact on the LEC's investment and resource allocation decisions. Nevertheless, in designing a regulatory system, it is important that proper signals are sent to the regulated entities. The sharing mechanism clearly sends
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In addition, the elimination of sharing will help to ease other regulatory burdens.[126] Sharing perpetuates the need for a complex and often arbitrary cost allocation process.[127] The cost allocation procedures greatly complicate the regulatory process and require large amounts of both Commission and LEC resources to be devoted to related activities such as depreciation reform[128] and affiliate transaction issues.[129]

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[125](...continued)
the wrong message for encouraging investment in the LECs' regulated, domestic telecommunications business.

[126] Professor Harris observes that sharing plans are much more costly and complex to administer than pure price regulation. Harris at 20. "[C]ompliance and monitoring costs increase considerably when a price regulation plan is overlaid by rate of return regulation, as is required with a sharing plan." Id.

[127] A cost allocation process is not necessary with pure price regulation because, without sharing, there is no incentive to cross-subsidize competitive services or to price those services below incremental costs. See Harris at 21.

[128] The Commission precluded price cap LECs from utilizing the so-called "Price Cap Carrier Option" in the depreciation simplification proceeding, largely on the grounds that LECs might influence their earnings levels through selection of their own depreciation rates. See Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Report and Order, FCC 93-452, released October 20, 1993, ¶¶ 42, 43. Elimination of sharing would remove the last policy barrier to allowing price cap LECs to control their depreciation rates, as LEC competitors already do, and would make LEC depreciation rates truly endogenous as was envisioned by the Commission when it ruled that depreciation was not an exogenous cost. See Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd at 6809.

[129] The Commission recognized that "affiliate transactions rules are necessary to assist [the Commission] in
(continued...)

The elimination of sharing will also make it easier to remove services from price cap regulation as markets become more competitive. As Commissioner Barrett has recognized:

> [A]s long as we impose an overall rate of return ceiling, we must either regulate the prices of all services, even if it's only incidentally through the imposition of a cap, or we must engage in some sort of cost allocation scheme between those services we regulate and those services we don't.
>
> Cost allocations will become increasingly difficult and meaningless in the future given the changes that are taking place, and so we are left to regulate services which the market is not only capable of regulating, but in fact is trying to regulate. That introduces the very real possibility of pricing distortions, and it is likely to cause disincentives for carriers to invest in and introduce new services.
>
> However, if we drop the rate of return ceiling while continuing to maintain our ability to regulate prices, we can transition services out of regulation smoothly as they become more competitive. And we can more easily give the carriers additional pricing freedom as competition is developing.[130]

Thus, the elimination of sharing would greatly enhance the Commission's ability to account for market changes within the price cap plan.[131] With sharing, the Commission

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[129](...continued)
determining the LECs' sharing obligations . . . ." Amendment of Part 32 and 64 of the Commission's Rules to Account for Transactions between Carriers and Their Nonregulated Affiliates, Notice of Proposed Rulemaking, CC Docket No. 93-251, FCC 93-43, released October 20, 1993, ¶ 103. The Commission stated that if it should decide to alter the sharing mechanism in this proceeding, it can "reevaluate the appropriate extent to which the affiliate transactions rules should apply to the price cap LECs." Id.

[130] Barrett Speech, pp. 7-8 (emphasis supplied).

[131] Professor Harris believes that regulatory "policies should attempt to be responsive to current and expected
(continued...)

will either have to regulate all services, including those that are subject to effective competition, or impose a burdensome and distortion-inducing cost allocation scheme. By removing the sharing requirement now, the Commission can transition to a more competitive access market in an orderly fashion while preserving full price regulation where necessary.[132]

In sum, by eliminating sharing, the Commission would increase incentives for efficiency, innovation and network investment. Such action would also have positive implications for economic growth. The removal of sharing would eliminate a substantial amount of complexity associated with the Commission's regulatory programs, and would facilitate efforts to reflect changing competitive market conditions in the price cap plan. These benefits of eliminating sharing clearly outweigh whatever benefits might have been afforded by a "backstop" during the initial price cap period.[133]

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[131](...continued)
market changes in the industry being regulated and in related industries." Harris at 16.

[132] At Section IV.C below, USTA proposes a market-based mechanism which will accomplish this orderly transaction.

[133] To the extent that the backstop was intended to compensate for uncertainty in the Commission's calculation of the aggregate level of the productivity offset, that concern is fully satisfied by determining the offset based on the direct measurement of total factor productivity as proposed by USTA. See Section IV.D below.

For all of these reasons, sharing should be eliminated from the LEC price cap plan.

Although it does not affect price cap incentives to the same degree or in the same manner as sharing, the low-end adjustment mechanism should also be eliminated as a back-stop. LECs, of course, retain the ability to file tariff revisions when warranted by economic circumstances. However, with the elimination of sharing, LECs should not be afforded automatic upward adjustment for underearnings.

Moreover, the low-end adjustment mechanism perpetuates the tie to cost-based regulation that has no place in a revised price cap plan.[134] The Commission must fully sever that tie in order to ensure that customers in less competitive markets will not be affected by changes in price or demand in more competitive markets. For example, under the current price cap plan, if a LEC reduces prices in more competitive markets, or simply loses business there, the LEC's overall interstate earnings may be depressed sufficiently to activate the low-end adjustment mechanism. This, in turn, would give the LEC the ability to raise prices in

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[134] Because it is advocating the complete elimination of sharing and the low-end adjustment mechanism, USTA is not responding to **Baseline Issue 4a** which asks "[w]hether the sharing and low-end adjustment mechanisms should be re-aligned with capital costs, and if so, how this should be done." (NPRM, ¶ 55)

less competitive markets.[135] This artificial link between competitive and less competitive markets would not exist under pure price cap regulation.[136]

B. The Commission Must Eliminate the Codification of All Access Rate Elements Except Public Policy Elements.

Under the Commission's existing rules, it is exceedingly difficult for price cap LECs to introduce new service offerings in a timely fashion, and to repackage existing services. Part of this difficulty is caused by the new service pricing rules.[137] But, the heart of the problem centers on the rigid rate structure requirements of Part 69. As the Common Carrier Bureau staff has noted, "new technologies challenge the static nature of the Part 69 rules and highlights the need for reform to accommodate and encourage innovation."[138]

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[135] Professor Harris notes that sharing with low-end adjustments leaves customers at risk, since they "share" in any underearnings by the LEC. Harris at 19.

[136] A pure form of price regulation would essentially shift the risks of operating in a more dynamic telecommunications environment from the LECs' customers to its shareholders, who should bear the risks of bad decisions and reap the rewards of good decisions. See Harris at 18; see also Harris at 20. (A "system of market pricing of competitive services and pure price caps eliminates ratepayer risk from unsuccessful investments and/or inefficient management.")

[137] These rules are discussed below at Section IV.C.3.

[138] "Federal Perspectives in Access Charge Reform: A Staff Analysis," Access Reform Task Force (April 30, 1993), p. 20.

The Part 69 rules must be flexible to accommodate the introduction of new services and technologies. A LEC should not be required to file a petition to change the existing rules, or to submit to a lengthy waiver process, solely because a new or restructured service does not fit within a rate structure that was prescribed over 10 years ago during a period marked by relatively slow technological advances and limited competition in access markets. Professor Harris states that "consumers will pay the costs if [new] services are subject to unnecessary regulatory obstacles that slow down their introduction into the marketplace and place unnecessary constraints on their pricing."[139]

The waiver process places a heavy burden on the LEC to justify why the waiver should be granted.[140] The waiver process, and the attendant delay in bringing new services to market, merely adds to the disincentives for innovation built into the existing price cap plan.[141] No other segment of the telecommunications industry must wait close to a

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[139] Harris at 23.

[140] See Ameritech Operating Companies, supra, 6 FCC Rcd at 747, quoting WAIT Radio v. FCC, 418 F.2d 1153, 1157 (D.C. Cir. 1969) ("[A]n applicant for waiver faces a high hurdle even at the starting gate.") This burden appears inconsistent with the policy and requirements set forth in Section 7 of the Communications Act concerning new services and technologies. See 47 USC § 157 (1993).

[141] See Harris at 23. (The Commission's regulation "dull[s] the incentives for investment in the provision of new services.")

year, or more,[142] to obtain approval to file a tariff for services that are being introduced to meet customer demand, and then wait anywhere from 45 to 120 days for the tariff to take effect.

USTA is particularly concerned that as new and repackaged services are required to meet future customer needs, it will become increasingly difficult to fit those services in a rigid rate structure designed around 1983 technology.[143] This will further lengthen the intolerable delays already experienced when LECs attempt to offer new services. For example, potential new services which provide private line functions using shared switched facilities under software control, will appear to be "switched" services under current rules. The switched rate structure prescribed for these services, however, is incompatible with their function. Waiver will be required in order to price such services in a manner consistent with market expectations.

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[142] See, e.g., New York Telephone Company; New England Telephone and Telegraph Company, 6 FCC Rcd 1588 (1991) (waiver to establish separate rate elements for Busy Line Verification and Busy Line Verification/Interrupt services conditionally granted more than **13 months** after petition was filed); Southwestern Bell Telephone Company, 6 FCC Rcd 6095 (1991) (waiver to establish a new rate element for common channel signalling interconnection service conditionally granted **16 months** after petition was filed); Southwestern Bell Telephone Company, 6 FCC Rcd 6101 (1991) (waiver to establish information surcharge rate element granted **10 months** after petition was filed).

[143] The unpredictability of today's telecommunications industry underscores the need for flexibility in the pricing and terms of new service offerings. See Harris at 24.

Further, the switched access rules provide for only two-point service, while some new services will likely involve multipoint bridging arrangements. Other new services will provide both dedicated bandwidth, like today's special access services, and usage-based functions similar to today's switched access services, on an integrated basis. The current rules do not accommodate functions that straddle the Part 69 categories.[144]

Only by eliminating the rate structure codification of Part 69, except for the Public Policy rate elements, can the Commission ensure that the Part 69 rules do not delay or otherwise frustrate the introduction of new and innovative services to meet changing customer demand.[145] Without such

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[144] While it is not possible to list all of the new access and related services that will be made available in the future, it is clear that many of them will require Part 69 waivers. Some examples of potential new services for which waivers will be required include: **Switched High Speed Service**, a switched n x 1.544 Mbps service for point-to-point and point-to-multipoint applications; **Switched Fractionalized 1.544 Mbps Service**, which includes non-ISDN switched 1.536 Mbps service, ISDN switched .384/1.536 Mbps service, and ISDN n x 64 fractional 1.544 Mbps services; **Multimedia Conferencing Service**, which includes transport, switching and bridging of audio, data and video information streams; **Customer Network Management**, which includes information on circuit performance, and customer control of service parameters and bandwidth for both switched and special access capabilities; and **Personal Access Service**, which will facilitate the receipt of incoming calls while the subscriber is away from his/her primary station.

[145] See USTA Petition, p. 21. As discussed below, elimination of the Part 69 rate element codification should be accompanied by a restructuring of the current price cap baskets into four baskets based on service functionality, including Transport, Switching, Public Policy and Other.

action, LEC service introductions will continue to be subject to untenable delays and the Commission's goals of promoting innovation, network investment, and full and fair competition will be seriously impaired.

The only exception to the decodification of the Part 69 rate structure is the specification of Public Policy rate elements that could apply to all LECs.[146] Because of the role these rate elements play in achieving important policy objectives, such as universal service, USTA believes that they should be specifically enumerated in the Commission's rules.[147]

USTA stresses that the elimination of rate structure codification will not harm consumers. The public has not been harmed by the existing decodification of LEC special access services. Moreover, no harm has resulted from the lack of codification of AT&T's rate structure. Finally, the tariff review process will be more than adequate to address any concerns over rate restructuring or service withdrawal.

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[146] See USTA Petition, pp. 21-22.

[147] The Public Policy elements would include the following: Lifeline Assistance, Universal Service Fund, End-User Common Line Charge, Carrier Common Line Charge (or a substitute recovery mechanism), Long-Term Support, Interconnection Charge, Telecommunications Relay Service, Special Access Surcharge, and any other elements established by the Commission for explicit interstate public policy purposes.

C. A Revised Price Cap Plan Must Afford Increasing LEC Pricing Flexibility As Access Markets Become More Competitive - Baseline Issue 9b.

USTA has shown (Section III.C above) that there is real and increasing competition in many LEC access markets, and that the Commission must implement now a mechanism to provide LECs a degree of pricing flexibility which is commensurate with the level of competition in particular markets. Such action is necessary if the Commission is to promote full and fair competition, and to achieve a measure of balance between the regulatory treatment of LECs and the treatment of competitive access providers (CAPs) and others.[148] As noted by two prominent economists who have studied the Commission's pricing rules and USTA's proposal, the existing "restrictions on LEC access pricing flexibility are ultimately anticompetitive, as they prevent customers from taking advantage of competition among LECs and CAPs to realize price reductions."[149]

The USTA Petition proposes revisions to the Commission's current rules which would permit increased LEC

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[148] Unless a LEC is given the flexibility to respond to competitive market initiatives, the LEC may lose substantial business even though the LEC may be no less efficient or creative than its unregulated competitor. See Harris at 24.

[149] Schmalensee and Taylor at 6.

pricing flexibility that is tied to the level of competition in a market.[150] USTA's proposal is detailed below.

1. LEC Pricing Flexibility Should Be Tied to the Degree of Competition in a "Market Area" - Transition Issues 1b, 1c and 2.[151]

a. The Market Area Concept.

A primary feature of USTA's pricing flexibility proposal is a three tier market structure consisting of Initial Market Areas (IMAs), Transitional Market Areas (TMAs) and Competitive Market Areas (CMAs). The degree of pricing flexibility afforded a LEC would increase as a market area is reclassified from IMA to TMA, and from TMA to CMA, based on the level of effective competition within the area.[152]

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[150] USTA Petition, pp. 24-33.

[151] See USTA's Position Paper "Competitive Market Area Demonstration and Data Reporting Requirements," for a more detailed discussion of the concepts and proposals set forth in this section. A copy of this paper is appended to these comments as Attachment 9.

[152] USTA's market area proposal is an "adaptive" form of regulation. Professor Harris defines "adaptive" as a policy framework which "enables change to occur more or less automatically as market conditions change." Harris at 17. Harris notes that unless the price cap reforms are adaptive, the Commission will be forced to "go back to the drawing boards" as soon as it becomes evident that a non-adaptive price cap plan is no longer working. Id.

Initially, each of a LEC's current study areas or pricing zones[153] would be classified as an IMA. The LEC may seek to reclassify all or part of an IMA to a TMA based on market power/competitive criteria relevant to individual wire centers within the IMA. A LEC wire center is the smallest possible geographic area to which a competitive market analysis can be applied.[154] Reliance on wire centers is appropriate because it minimizes the possibility of unreasonable price discrimination against customers without competitive alternatives.[155]

b. Measuring Market Power.

Wire centers would be classified as TMAs or CMAs based on the extent of the LEC's market power within the wire center as measured by objective standards. Parties have proposed several ways to measure market power, including market share, supply capacity, and the concept of contestability.

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[153] Zones are comprised of wire centers possessing similar traffic density characteristics, as provided by the Commission in Expanded Interconnection with Local Telephone Company Facilities, CC Docket No. 91-141, Report and Order, 7 FCC Rcd 7369 (1992).

[154] See Schmalensee and Taylor at 23. A grouping of wire centers may also be appropriate for a competitive market analysis. For services that are not geographically-based (*e.g.*, services provided through a regional database), it may be appropriate to use a larger geographical area for competitive market analysis.

[155] See id. at 23.